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Economic Research
& Planning Division

The Economic Outlook

October 1979

The actions of the Federal Reserve on October 6 seemed to jar expectations of where the economy was headed. Within three business days of the announcement, the Dow Jones industrial average dropped 5%, while the money markets groped for direction after sharp increases in yields. The steep rise in rates as a result of the Fed's moves will make the economic downturn somewhat deeper than expected. The really significant change, though, is the Fed's avowed intention to try to control growth in bank reserves--and hence the money supply--without keeping the Federal funds rate in a narrow band as it has in the past. For years, the monetarists have argued that the Fed's fixation on Federal funds targets kept it from meeting its objectives in controlling monetary growth. The Fed has finally yielded to their argument.

We are looking for declines in the level of economic activity in the first half of 1980, followed by a recovery beginning about mid-year. The recession will likely be deeper than we had previously anticipated, though still considerably less severe than in 1973-1975.

The impact of the recent rise in rates will be particularly noticeable now. In several states, below-market mortgage usury ceilings were already restricting the availability of mortgage financing. The latest increase in rates has caused mortgage rates to bump up against usury ceilings in many other states as well. Even in states where legislative bodies have recently raised ceilings to more realistic levels, these ceilings are already outdated. Housing starts are thus likely to suffer as a result of the Fed's actions.

Sales of consumer durable goods, such as furniture and appliances, will also be affected by the rise in rates to the extent that installment financing becomes more difficult to obtain. Since rates on consumer loans are generally stable even when other rates are gyrating, commercial banks and finance companies may tighten their credit requirements on installment loans as they find their margin on these loans being squeezed. And as the cost of financing inventories becomes an increasingly important consideration for many corporations, they will make a concerted effort to trim excessive inventories.

The economic picture remains spotty: some sectors have been quite weak and still have some rough sailing ahead, while other sectors will be virtually unaffected by the storm. For example, as of August, production in the aerospace industry was 12.7% above the year-ago level, and the aircraft manufacturers' orders books are bulging. In the last recession, the economy did not benefit from such support. Production in this industry rose 1.0% in 1974 but then fell 6.5% in 1975 and drifted lower even as the recovery began.

The auto industry is an obvious example of a troubled sector of the economy today. Domestic auto sales averaged 8.8 million units at a seasonally adjusted annual rate in August and September after the 7.3 million unit disaster in June. The rebound, though, was supported by Chrysler's $400-a-car rebate and by widely publicized dealer incentive programs at Ford and GM. The auto industry has also been helped by the smooth settlement of the UAW-GM negotiations. But by late this year and early next year, auto sales could again falter, though not as badly as when gasoline lines were common.

Bernard Schoenfeld

IRVING TRUST COMPANY ECONOMIC FORECAST
(Percent Changes at Annual Rates)

	ACTUAL 1979		FORECAST 1979		1980				ACTUAL 1977-1978	FORECAST 1978-1979	FORECAST 1979-1980
	I	II	III	IV	I	II	III	IV			
Gross National Product	10.6	6.7	11.7	10.5	5.8	3.3	11.8	14.4	12.0	11.3	8.2
Real GNP	1.1	-2.3	2.0	1.0	-3.2	-5.3	3.1	6.2	4.4	2.1	-0.8
GNP Price Deflator	9.3	9.3	9.5	9.4	9.3	9.1	8.4	7.7	7.3	9.0	9.1

	ACTUAL 1979:II	FORECAST 1979:III	ACTUAL 1977-1978	FORECAST 1978-1979	FORECAST 1979-1980
Consumer Spending	6.1%	12.6%	11.6%	11.2%	9.2%
Durable Goods	-9.2	22.8	12.0	7.9	3.4
Nondurable Goods	7.3	11.8	10.2	11.3	9.3
Services	10.4	10.2	12.7	12.3	11.0
Business Capital Spending	9.6	15.3	16.7	14.7	9.3
Structures	29.1	17.4	22.2	20.1	11.4
Equipment	0.2	14.1	14.1	12.0	8.0
Residential Investment	6.1	14.6	17.5	6.5	3.6
Change in Inventories	$33.4 b.	$32.1 b.	$22.3 b.	$28.8 b.	$6.3 b.
Net Exports of Goods and Services	$-8.1 b.	$-8.0 b.	$-10.3 b.	$-5.5 b.	$-3.2 b.
Government Purchases of Goods and Services	5.8%	8.0%	9.9%	8.7%	10.3%
Federal	-4.6	5.3	5.7	8.3	11.5
State and Local	11.9	9.5	12.4	9.0	9.6
Corporate Profits Before Tax	10.0*	8.8*	16.3	11.4	-4.8
Corporate Profits After Tax	13.8*	13.6*	16.3	15.4	-3.7
Plant and Equipment Expenditures	19.5	18.2	12.7	14.8	10.8
Real Final Sales#	-3.9	1.7	4.4	1.9	0.1
Real Disposable Personal Income	-1.4	3.1	4.6	2.8	1.7

	RECENT DATA			ACTUAL	FORECAST	
ECONOMIC INDICATORS	June	July	Aug.	1977-1978	1978-1979	1979-1980
Consumer Price Index**	12.0%	12.0%	13.2%	9.0%	13.3%	9.8%
Producer Price Index for Finished Goods**	6.0	13.2	14.4	9.1	12.2	9.6
Industrial Production	0.0	1.6	-13.4	5.8	4.2	-1.5
Retail Sales##	-0.2	0.7	0.7	10.3	11.0	9.7
Auto Sales (millions of units,a.r.)	9.6	10.6	11.0	11.3	10.8	10.0
Housing Starts (millions of units,a.r.)	1.92	1.79	1.78	2.02	1.74	1.55
Unemployment Rate	5.6	5.7	6.0	6.0	5.9	7.0
Merchandise Trade Deficit (a.r.)	$22.8 b.	$13.3 b.	$28.3 b.	$28.5 b.	$27.0 b.	$21.0 b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.
#GNP less change in inventories, both in real terms.
*Year-over-year percent changes.
**Annual percent changes are December to December (not seasonally adjusted).
##Monthly percent changes are not annualized.
$b. = billions of dollars. a.r. = annual rate. F = Forecast.

October 15, 1979